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In the Supreme Court of the United States

OCTOBER TERM, 1976

CHURCHILL FOREST INDUSTRIES (MANITOBA) LTD., ET AL.,
PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A) is reported at 548 F. 2d 109. The opinion of the district court dismissing the original complaint (Pet. App. B) is reported at 391 F. Supp. 1167; the opinion of the district court dismissing the amended complaint (Pet. App. C) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on January 14, 1977. The petition for a writ of certiorari was filed on March 15, 1977. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the district courts have subject-matter jurisdiction under the federal securities laws of a suit by the Securities and Exchange Commission to enjoin defendants from engaging in further fraudulent activity in the United States on the basis of allegations that substantial fraudulent conduct essential to defendants' scheme to defraud a Canadian company occurred in the United States.

STATUTES AND RULE INVOLVED

Sections 17(a), 20(b), and 22 of the Securities Act of 1933, 48 Stat. 84, 86, as amended, 15 U.S.C. 77q(a), 77t(b), and 77v, Sections 10(b) and 27 of the Securities Exchange Act of 1934, 48 Stat. 891, 902, as amended, 15 U.S.C. 78j(b) and 78aa, and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5, are set forth at Pet. App. A40-A44.

Section 2(7) of the Securities Act of 1933, 48 Stat. 75, 15 U.S.C. 77b(7), provides in pertinent part:

> The term "interstate commerce" means trade or commerce in securities or any transportation or communication relating thereto among the several States * * * or between any foreign country and any State * * *.

Section 3(a)(17) of the Securities Exchange Act of 1934, 48 Stat. 884, 15 U.S.C. 78c(a)(17), provides in pertinent part:

> The term "interstate commerce" means trade, commerce, transportation, or communication among the several States, or between any foreign country and any State, or between any State and any place or ship outside thereof.

Section 21(d) (former Section 21(e)) of the Securities Exchange Act of 1934, as redesignated, 89 Stat. 154, 15 U.S.C. (Supp. V) 78u(d), provides in pertinent part:

> Wherever it shall appear to the Commission that any person is engaged or is about to engage in any acts or practices constituting a violation of any provision of this title * * * [or] the rules or regulations thereunder * * *, it may in its discretion bring an action in the proper district court of the United States * * * to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond.

STATEMENT

1. The Securities and Exchange Commission filed an enforcement action against petitioners in the United States District Court for the District of New Jersey, alleging violations of antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934.[1] The Commission sought an injunction against further violations and ancillary relief (C.A. App. 9-41, 123-181).[2]

The amended complaint alleged that petitioners and others engaged in schemes to defraud, and made misrepresentations to, the Manitoba Development Fund ("Fund"), a corporation owned by the Province of Manitoba, Canada, in connection with the purchase and sale of securities; these consisted of investment contracts, deben-

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[1]The complaint alleged violations of Section 17(a) of the Securities Act, 15 U.S.C. 77q(a), Section 10(b) of the Securities Exchange Act, 15 U.S.C. 78j(b), and SEC Rule 10b-5, 17 C.F.R. 240.10b-5.

[2]"C.A. App." refers to the appendix in the court of appeals.

tures, and common and preferred stocks (C.A. App. 127-129, 149-151). Some of these securities were issued by petitioner River Sawmills Company ("River"), a Delaware corporation with offices in Montclair, New Jersey, and also in Spokane, Washington, and others by petitioner Churchill Forest Industries (Manitoba) Ltd. ("C.F.I."), a Manitoba corporation with offices at the same location in Montclair, New Jersey (C.A. App. 125-129, 149-151). Defendant Alexander Kasser and one or more of the other individual defendants induced the Fund to enter into investment contracts with C.F.I. and River, and to invest in debentures of these corporations on an installment basis, through false representations that they or companies they controlled would invest and had invested capital in equity securities of C.F.I. and of River in amounts in excess of the proceeds obtained by these corporations from the sale of the debentures to the Fund (C.A. App. 127-129, 149-151).[3]

Under the investment contracts between the Fund and C.F.I. and River, the Fund was to make loans to these corporations by disbursing money to them on an installment basis, in return for which they were to issue debentures to the Fund. Each loan disbursement was to be made only upon a certification to the Fund that an investment of a specified amount by certain of the defendants or companies

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[3]The defendant Alexander Kasser is not a petitioner. The Commission had not succeeded in obtaining service upon him at the time the petition was filed.

Except for statements to the effect that the individual defendants are United States citizens, the statements of fact in the text are taken from the allegations in the amended complaint, which must be deemed accurate for purposes of the jurisdictional issue presented here. It was not disputed in the district court that the individual defendants were United States citizens, and the district judge referred to Kasser as "a United States citizen" (Pet. App. A16) and referred generally to the "existence of American defendants * * *" (Pet. App. A32).

controlled by them had been made in the equity securities of C.F.I. and River. All of the money so invested in C.F.I. and River was to be spent to establish a forestry complex in Manitoba, which was to be owned and operated by C.F.I. and River (C.A. App. 127-128, 140, 150-151).

In fact, the defendants never intended to provide the equity investments required by the contracts. Instead, they intended to, and did, make the purported equity investments with portions of the loan disbursements made by the Fund (C.A. App. 147-149, 172-173). This was accomplished by diverting portions of the loan disbursements through various corporations and bank accounts in the United States, Switzerland, and Canada (C.A. App. 141-144, 148, 159-162, 174). Over a period of several years the Fund invested approximately $45,000,000 in the debt securities of C.F.I. and River and, during the time that these payments were made, the defendants engaged in continuous misrepresentations and repeatedly concealed material facts from the Fund (C.A. App. 128-129, 146-149, 150-151, 164, 172-175).

By their conduct, the individual defendants created the false impression that the purported owners of C.F.I. and River had risked substantial equity capital in the development of the forestry complex; they also concealed their own extensive self-dealing in connection with the construction of the complex, enabling them to divert to their own use and benefit a substantial part of the Fund's investment in C.F.I. and River. As a result, both C.F.I. and River became bankrupt (C.A. App. 125-129, 150-151).

The defendants, except for C.F.I., are all United States citizens or corporations, and all, including C.F.I., have offices and do business in this country (C.A. App. 124-126).

In order to induce the Fund to purchase securities of C.F.I. and River, defendants made numerous misrepresentations in the United States. In negotiating the financing agreements for C.F.I. in New York, the defendants made misrepresentations concerning the persons who would invest capital in C.F.I. (C.A. App. 129-130). In the course of negotiating the financing agreement for River in Montclair, New Jersey, the defendants misrepresented the ownership and control of River and of its parent, defendant Blue Construction Corporation ("Blue"), as well as the intention of the purported owners of River to invest additional capital in the corporation (C.A. App. 126, 155, 172-175). In order to obtain loan disbursements under the River financing agreement, the defendants, by means of phone calls and letters from the United States, made misrepresentations that equity capital was being invested in the securities of River (C.A. App. 159-162).

Defendants also used the United States as a base from which they devised, planned and directed their schemes to defraud the Fund (C.A. App. 128-129, 150-151). The schemes were planned at meetings among the defendants in Montclair, New Jersey, and Spokane, Washington (C.A. App. 128-129, 137, 152, 154). Defendants' records of all the transactions involved in the schemes and the corporate books of defendants C.F.I., River, Blue, and Technopulp Incorporated were maintained in Montclair, New Jersey (C.A. App. 129, 146, 148, 164). Most of defendants' bank accounts were maintained in banks located in the United States (C.A. App. 141-142, 153, 159-160), and those that were maintained in banks located in Canada or Switzerland were controlled by persons in the United States (C.A. App. 143, 148, 151, 157, 159-161). Defendants diverted substantial amounts of the funds obtained through their fraudulent schemes by recycling them through the bank accounts in the United States (C.A. App. 141-142, 148, 159-162). Several meetings between officials of the Fund and the defendants and their representatives were held in the United

States, and virtually all correspondence and other communications in connection with the transactions, including letters, wires, and phone calls, were sent from or to the defendants in the United States (C.A. App. 128-133, 138, 140-143, 151-155, 157-162, 164-171).

2. The district court dismissed the Commission's amended complaint for lack of subject-matter jurisdiction on the ground that "the alleged fraud was consummated in Canada where the * * * [Fund] transferred funds to defendants in exchange for debentures" and that the transactions had no significant effect within the United States or upon United States investors (Pet. App. A36).

The court of appeals reversed, holding that the district court had subject-matter jurisdiction over this "SEC suit for injunctive relief" (Pet. App. A5). The court pointed out that, even though "the sole victim * * * [of the alleged fraud was] a foreign corporation," "there was significant conduct which formed part of the defendants' scheme that did occur within this country" and "the defendants' conduct occurring within the borders of this nation was essential to the plan to defraud * * *" (Pet. App. A2, A4, A12). The court "decline[d] to immunize, for strictly jurisdictional reasons, defendants who unleash from this country a pervasive scheme to defraud a foreign corporation" (Pet. App. A10).

It also noted that if, after trial, "it should be disclosed that the allegedly fraudulent conduct of any of the defendants within this country was non-existent or was so minimal as to be immaterial, then the district court, or this Court on appeal, may be warranted in dismissing the action for want of jurisdiction" (Pet. App. A14; footnote omitted).

ARGUMENT

The decision of the court of appeals is correct. There is no conflict among the courts of appeals, or any other reason for

this Court to review this case in its present interlocutory posture.

1. Petitioners incorrectly assert that the court of appeals rested jurisdiction "merely on the basis * * * of *any* activity in furtherance of the alleged fraud in the United States * * *" (Pet. 2) and that it sought to exercise extraterritorial jurisdiction over an essentially foreign transaction on the ground that only "some conduct" within the United States occurred (Pet. 18-23). The decision below instead was based on the Commission's allegation that substantial fraudulent conduct occurred within the United States that was essential to the scheme to defraud (Pet. App. A2, A4, A12).

If at trial it is established that no fraudulent conduct occurred within this country, or such conduct was so minimal as to be immaterial, then the case might properly be dismissed on jurisdictional grounds (see Pet. App. A14). This case, therefore, is in the same posture as if the district court had denied petitioners' motion to dismiss, subject to proof by the Commission of its allegations that "significant conduct which formed part of the defendants' scheme * * * did occur within this country" (Pet. App. A4). Petitioners have shown no extraordinary circumstance warranting review by this Court at this preliminary stage of the proceedings.

2. The federal securities laws proscribe fraudulent conduct that occurs within the United States, even though the victim is a foreign investor located in another country and there is no impact on investors within the United States. See *Bersch* v. *Drexel Firestone, Inc.*, 519 F. 2d 974, 985 (C.A. 2), certiorari denied *sub nom. Bersch* v. *Arthur Andersen & Co.*, 423 U.S. 1018; cf. A.L.I., *Restatement (Second) of the Foreign Relations Law of the United States* § 17(a) (1965). The preambles to both the Securities Act and

the Securities Exchange Act recite Congress' intent to cover transactions "in interstate and foreign commerce and through the mails." 48 Stat. 74; 48 Stat. 881. The antifraud provisions themselves expressly apply to transactions involving the mails or interstate commerce, and the term "interstate commerce" is defined in both acts as extending to trade, commerce, transportation or communication "between any foreign country and any State."[4] It is evident from these broad provisions that Congress did not intend "to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners." *IIT* v. *Vencap, Ltd.*, 519 F. 2d 1001, 1017 (C.A. 2).

Notwithstanding the allegations that petitioners have engaged in substantial fraudulent conduct within the United States, petitioners contend that the district court lacked subject-matter jurisdiction because the effects of the alleged fraud were wholly foreign, *i.e.*, the Canadian corporation received the "CFI and River debentures in Manitoba in exchange for funds paid by it in Manitoba" (Pet. 4). But the securities laws proscribe fraudulent conduct, not simply fraudulent effects.[5]

This distinction is particularly significant in an enforcement action brought by the Commission. Private

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[4] See Section 2(7) of the Securities Act, 15 U.S.C. 77b(7); Section 3(a)(17) of the Securities Exchange Act, 15 U.S.C. 78c(a)(17).

[5] Thus, as the court of appeals observed (Pet. App. A10 n. 22; emphasis in original): "Rule 10b-5, 17 CFR. 240.10b-5, for example, prohibits any person participating in securities transactions falling within interstate commerce, from '*employ*[*ing*] any device, scheme or artifice to defraud' or '*engag*[*ing*] *in any act*, practice or course of business which operates or *would* operate as a fraud . . . .' * * * Similar language also is present in §17(a) of the 1933 Act, 15 U.S.C. §77(q)(a) and in §10(b) of the 1934 Act, 15 U.S.C. 78(j)(b)."

litigants seeking damages for securities fraud may be required to prove actual loss. But in a government enforcement action the Commission need not prove that any investor has suffered loss as a result of a defendant's fraudulent activities. *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-192.[6]

There are substantial reasons for this doctrine. As the court below noted (Pet. App. A13):

> First, to deny such jurisdiction may embolden those who wish to defraud foreign securities purchasers or sellers to use the United States as a base of operations. By sustaining the decision of the district court as to the lack of jurisdiction, we would, in effect, create a haven for such defrauders and manipulators. We are reluctant to conclude that Congress intended to allow the United States to become a "Barbary Coast," as it were, harboring international securities "pirates."
>
> * * * [A] holding of no jurisdiction might induce reciprocal responses on the part of other nations. Some countries might decline to act against individuals and corporations seeking to transport securities frauds to the United States.

[6]The same is true in criminal actions under the antifraud provisions, where "the government is not required to prove that anyone was defrauded or that any investor sustained loss." *Farrell* v. *United States*, 321 F. 2d 409, 419 (C.A. 9), certiorari denied, 375 U.S. 992. See also *United States* v. *Tallant*, 547 F. 2d 1291, 1295-1296 (C.A. 5).

As the Court of Appeals for the Second Circuit stated in *IIT* v. *Vencap, Ltd., supra*, 519 F. 2d at 1017:

> This country would surely look askance if one of our neighbors stood by silently and permitted misrepresented securities to be poured into the United States. By the same token it is hard to believe Congress meant to prohibit the SEC from policing similar activities within this country * * *.

The purpose of the antifraud provisions of the federal securities laws, "to insure high standards of conduct in securities transactions within this country * * *," is furthered by the decision below, which "enhance[s] the ability of the SEC to police vigorously the conduct of securities dealings within the United States" (Pet. App. A14).

3. a. Contrary to petitioners' contentions (Pet. 7-17), there is no conflict between the present case and other appellate decisions.[7] All but one of the cited six decisions involved private actions, not actions brought by the Commission.[8] In the action brought by the Commission, and indeed in all but one of the private actions,[9] subject-

[7]Petitioners rely upon *Bersch* v. *Drexel Firestone, Inc., supra*; *IIT* v. *Vencap, Ltd., supra*; *Leasco Data Processing Equipment Corp.* v. *Maxwell*, 468 F. 2d 1326 (C.A. 2); *Travis* v. *Anthes Imperial Ltd.*, 473 F. 2d 515 (C.A. 8); *Securities and Exchange Commission* v. *United Financial Group, Inc.*, 474 F. 2d 354 (C.A. 9); *Des Brisay* v. *Goldfield Corp.*, 549 F. 2d 133 (C.A. 9).

[8]The exception is *Securities and Exchange Commission* v. *United Financial Group, Inc., supra*.

[9]The exception was *Bersch* v. *Drexel Firestone, Inc., supra*, where no fraudulent acts were committed within the United States. See 519 F. 2d at 987. The same court in *IIT* v. *Vencap, Ltd., supra*, held that fraudulent activity within the United States was a basis for jurisdiction. The court below noted that both *Bersch* and *IIT*, as well as its own earlier decision in *Straub* v. *Vaisman & Co., Inc.*, 540 F. 2d 591, "lend great support for a holding of jurisdiction here" (Pet. App. A13).

matter jurisdiction in fact was sustained. While in some of these cases jurisdiction was exercised on grounds other than in this case, this evidences not a conflict but simply "a different case with different facts." *Bersch* v. *Drexel Firestone, Inc., supra*, 519 F. 2d at 985-986.

b. Nor is there a conflict between the decision below and decisions of this Court. *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, involved reconciling the provisions of the Arbitration Act and the antiwaiver provisions of the Securities Exchange Act in a private action. This Court specifically stated that the question of the applicability of the federal securities laws to international transactions "was not considered by the Court of Appeals and is not before this Court." 417 U.S. at 516 n. 9.

The decisions in *Benz* v. *Compania Naviera Hidalgo, S.A.*, 353 U.S. 138, and *McCulloch* v. *Sociedad Nacional*, 372 U.S. 10, involved the regulation of the internal affairs of foreign-flag vessels manned by foreign nationals. 353 U.S. at 142-143; 372 U.S. at 20-21. The very policy reasons relied upon by this Court in *Benz* and *McCulloch* in construing the National Labor Relations Act as not affording jurisdiction there—the avoidance of "international discord" and of "retaliatory action from other nations" (353 U.S. at 147; 372 U.S. at 21)—favor a decision upholding subject-matter jurisdiction here, where such discord and retaliatory action are more likely to result from a denial of jurisdiction. See Pet. App. A13-A14; *IIT* v. *Vencap, Ltd., supra*, 519 F. 2d at 1017-1018.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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